Horizon Actuarial Services, LLC

# Memo

Horizon Actuarial Services, LLC
8601 Georgia Ave, Suite 700
Silver Spring, MD 20910
Phone: 240.247.4600
Fax: 240.247.4600
www.horizonactuarial.com

| | |
|---|---|
| Date: | July 24, 2017 |
| To: | Board of Trustees – The New York State Teamsters Conference Pension and Retirement Fund |
| CC: | Kenneth Stilwell, John Ring |
| From: | Stan Goldfarb, Breck Sherwood, and Kevin Culp |
| **Subject:** | **Response to IBT Comments Regarding MPRA Application** |

On July 14, 2017, the International Brotherhood of Teamsters ("IBT") submitted comments to Treasury Secretary Mnuchin asking him to reject the Multiemployer Pension Reform Act of 2014 ("MPRA") suspension of benefits application submitted by the New York State Teamsters Conference Pension and Retirement Fund ("Plan" or "Fund"). This memo addresses the comments made by the IBT.

It was of the utmost importance to the Fund to design a suspension plan that met the criteria to allow for the Plan's survival, to have as minimal an impact as possible on the benefits of the participants, and to comply with the requirements of MPRA. The application submitted to the Treasury Department on May 15, 2017 satisfies these criteria. We do not believe it is prudent to hold off on the application and wait for Congress to approve other viable solutions. The Fund's financial situation gets worse the longer it waits. Although benefit suspensions are difficult, the alternatives are far worse. If the Fund's application is not approved and there is no legislative solution, then the Plan will become insolvent and participants' benefits will be reduced to essentially nothing, rather than to the amounts proposed in the suspension application.

We believe that the comments submitted by the IBT are more of a critique of MPRA rather than a critique of the application submitted by the Fund. Many of the "issues" cited in the IBT comments are a result of the Fund following the requirements of MPRA. For example, the IBT notes that if actual investment experience or work level experience is worse than assumed, the Plan would be projected to go insolvent. Under MPRA, a plan is required to suspend benefits by the minimum amount needed that will allow the plan to remain solvent, given a certain set of assumptions. In other words, by law, there is no cushion or margin allowed in the projections. So, the Plan is required to be projected to go insolvent if investment returns or work levels are significantly less than assumed. Any plan that would not go insolvent, if investment returns or work levels were less than assumed, suspended benefits more than what was necessary to avoid insolvency.

The assumptions used in the suspension application were based on historical experience of the Plan and represent our best estimate of future experience for the purposes of the measurement. The assumptions are all individually reasonable and were developed based on input from the Trustees and the Plan's investment consultant, where applicable. We revised some assumptions from the original application based on the concerns cited by the Treasury Department. We believe that we have addressed all of Treasury's concerns. The actuaries for the Retiree Representative reviewed the actuarial assumptions used in the application and also concluded that the assumptions were reasonable.

More detail on the IBT's comments is provided below.

**IBT Comment:**
"The assumption changes asserted by the New York Teamsters in its new application do not improve the likelihood of projected solvency of the Fund."

**Response:**
The Fund submitted a revised application where all the assumptions were individually reasonable and reasonable in the aggregate given the purpose of the measurement. The assumptions are based on the actual historical experience of participants in the Plan and represent our best estimate of future experience for the purposes of the measurement. The initial application was withdrawn because Treasury had concerns about the mortality assumption and the investment return assumption. The revised application includes a more conservative mortality assumption, which improves the likelihood of the Plan's solvency by not understating the expected benefit payments of the Fund.

**IBT Comment:**
"The suspension of benefits and the assumptions proposed by New York Teamsters in their current application fail to meet the standards set by MPRA to maintain the Fund's solvency."

**Response:**
We believe that the suspension of benefits and the assumptions used in the current application meet the standards set by MPRA to maintain the Fund's solvency. The Fund designed a suspension plan that allows for the Plan's survival, has as minimal an impact as possible on the benefits of the participants, and complies with the requirements of MPRA.

**IBT Comment:**
"Specifically, the various sensitivity tests prepared by the Fund as required by Section 6.04 of Revenue Procedure 2016-27, indicate without a doubt that if the Fund does not meet its application assumptions exactly, the Fund will become insolvent during the solvency period (30 years)."

**Response:**
Under MPRA, a plan is required to suspend benefits by the minimum amount needed that will allow the plan to remain solvent, given a certain set of assumptions. In other words, there is no cushion or margin allowed in the projections. So, of course the Plan would be projected to go insolvent if investment returns or work levels are significantly less than assumed. The various sensitivity tests required by Section 6.04 of Revenue Procedure 2016-27 do show that the Fund will become insolvent during the solvency period (30 years). Any plan that would not go insolvent, if investment returns or work levels were less than assumed, suspended benefits more than what was necessary to avoid insolvency. These sensitivity projections are required under every MPRA application.

The sensitivity projections do not, however, indicate without a doubt that the Fund will become insolvent if assumptions are not exactly met.

**IBT Comment:**
"The current application, like the original application, assumes the active plan population decreases by 2% per year, but optimistically assumes that UPS, ABF and YRC actives will remain at 2016 levels."

**Response:**
We developed the active population assumption based on actual historical experience of the Plan and input from the Trustees regarding future work levels. It represents the best estimate of future work levels and is not optimistic or pessimistic. Based on information from the Fund Office, contribution base units for the employers mentioned above have remained steady or slightly increased over the five year period prior to the application.

**IBT Comment:**
"The current application assumes larger increases in employer contributions for the first four years (3.5%) compared to the original application for purposes of projecting that the plan will become insolvent without the cuts, the same 3% annual increases for the next five years, and zero contribution increases thereafter."

**Response:**
We do not understand the IBT's concern regarding contribution rate increases. For the original Critical and Declining Status certification in January of 2016, we used a contribution rate increase assumption of 3% per year because that was the best estimate at the time of the certification. In preparing the first application for a suspension of benefits effective July 1, 2017, the schedules for future increases in contribution rates were reevaluated. As part of this review, consideration was given to macroeconomic factors, the financial strength of participating employers, competition in the marketplace, the relationship between contributions and benefit levels, and expected changes in wage packages over the next several years. Based on this review, we developed the assumption described in the application.

**IBT Comment:**
"After suspending active participants' benefits by 18% and inactive participants' benefits by 29%, which acts to remove $670 million of benefit liability, the Fund is still only 43.44% funded in 2018. During the next 23 years, that funded ratio declines to 30.53% in 2040, and recovers to 42.03% in 2049. . . The above scenario is essentially a best case, with the Fund meeting every assumption in the current application in each and every year. The best we can expect is that the New York Teamsters will remain a highly-troubled plan on the verge of insolvency even if the application is granted."

**Response:**
As mentioned above, the Fund designed a benefit suspension that will reasonably allow the Plan to remain solvent without suspending benefits more than what is necessary. The intent of MPRA was not to immediately return plans to the Green Zone, but to allow plans to remain solvent. This is accomplished by a provision in MPRA whereby a Plan cannot suspend benefits more than the amount necessary for the Plan to avoid insolvency. If the Fund were to slightly reduce suspensions, as shown in the information required under Section 4.03 of Revenue Procedure 2016-27, the Fund is projected to be insolvent in the year ended 12/31/2049. This verifies that the Plan meets the requirements of MPRA by demonstrating the benefit suspensions do not materially exceed the amount necessary to avoid insolvency. If the projected funded percentages were greater than those shown in the application and described in the IBT's comments, then the benefit suspension application would not comply with MPRA, because the benefit suspensions would be greater than what is necessary to avoid insolvency.

**IBT Comment:**
"Finally, the New York Teamsters' application is predicated on a risky investment strategy that is subject to a number of questionable outcomes."

**Response:**
The investment return assumption must be the best estimate of future experience of the Fund and cannot include arbitrary conservatism. The initial application was withdrawn because Treasury had concerns about the investment return assumption. We addressed these concerns in the revised application.

We developed the investment return assumption based on the Plan's target asset allocation, considering the results of the 2016 Survey of Capital Market Assumptions by Horizon Actuarial Services, LLC (the "2016 Survey") and input from the Plan's investment consultant.

The assumption also reflects the possibility of future changes in the Plan's asset allocation to satisfy Plan liquidity needs. An analysis was performed considering the expected changes in the Plan's assets and determined that the Plan will not have to prematurely sell any of its illiquid assets (private equity) at a loss or with a penalty. This is because the Plan is expecting distributions from its private equity investments in excess of the expected decrease in the private equity assets of the Plan. Distributions in future years are expected to be large since the Plan has a mature private equity investment program. The majority of the Fund's investments in the program were made during the first four years of the program (vintage years 2006-2009). Investments in the limited partnerships for vintage years 2006-2009 are expected to last approximately 10 years. So, the lifetime of the investments made in 2006-2009 will be ending in 2016-2019. Because the majority of the Fund's private equity investments are ending in 2016-2019, the Fund is expecting larger distributions from the program in these years.

While the Plan's significant private equity holdings do have more expected volatility than other asset classes, they were chosen because they have higher expected return than those classes. Furthermore, these investments have provided strong performance for the Plan over the period they've been held and have boosted the investment returns of the Plan.

We fully stand behind the actuarial basis underlying the NYST suspension application.

Please let us know if you have any questions or if you would like to discuss this memo.